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102495—34

In the Supreme Court of the United States

OCTOBER TERM, 1934

No. ——

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

JAMES L. RANKIN, EXECUTOR OF THE ESTATE OF Richard B. Turner, deceased

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Third Circuit, entered in the above cause on September 18, 1934, reversing the decision of the United States Board of Tax Appeals.

OPINIONS BELOW

The findings of fact and opinion of the Board of Tax Appeals (R. 15–20) are reported in 26 B. T. A. 1204. The opinion of the Circuit Court of Appeals is reported in 73 F. (2d) 9.

JURISDICTION

The decision of the Circuit Court of Appeals reversing the Board of Tax Appeals was rendered September 18, 1934. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether shares of stock held on margin are capable of identification so that a taxpayer selling part of his holdings may select, as his basis for determining gain or loss, the cost of any particular lot.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791, 818:

> SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.
>
> (a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; * * *.

Treasury Regulations 74:

> ART. 58. *Sale of stock and rights.*—When shares of stock in a corporation are sold from lots purchased at different dates and at different prices and the identity of the lots cannot be determined, the stock sold shall be charged against the earliest purchases of such stock. * * *

STATEMENT

This is a proceeding for the redetermination of a deficiency in income taxes for the year 1928 in the sum of $11,173.05 asserted against one Richard B. Turner, who died in 1932, during the pendency of these proceedings, James L. Rankin, his executor, being substituted (R. 13–14, 41–42). The facts as found by the Board of Tax Appeals may be summarized as follows (R. 16–18):

Early in 1926 Turner purchased on marginal account with a Philadelphia broker 1,200 shares of United Gas and Improvement Company stock. For nearly two years he had no further marginal transactions. At the beginning of 1928 his marginal account was long 1,500 shares of U. G. I., the additional 300 shares representing a 25-percent stock dividend credited to him late in 1926.

In 1928 Turner began playing the market. Included in many marginal transactions he bought 1,000 shares of U. G. I., and at one time sold 300 shares, at another 500 shares, and at still another 500 shares of that stock. By the end of 1928 (the tax year) Turner's account was long 1,200 shares of U. G. I., the same number he bought in 1926.

Turner always intended to retain the ownership on margin of 1,200 shares of U. G. I., since he had faith in the company and desired to hold that in lieu of certain bonds which he had received from the estate of his father. In giving orders to his broker to sell the 1,300 shares in 1928 he did not

specify any particular shares to be sold, but an employee of the broker understood that Turner desired to retain 1,200 shares to take the place of the bonds which he had received from his father. The decedent had made it plain to his associates that the 1,200 shares were in the nature of a permanent commitment on his part.

In computing the gain from the sale of the 1,300 shares in 1928 the Commissioner in accordance with Article 58 of Regulations 74, *supra,* applied the sales against the first purchases of the stock. The Board of Tax Appeals sustained this action (R. 18–20), but the Circuit Court of Appeals reversed, holding that Turner's communication to his broker of his intention to hold the 1,200 shares first purchased as an investment was in effect an order to his broker not to sell those shares. The court decided that these instructions were in effect an identification of the shares later sold as those last purchased.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that, while certificates of stock cannot be identified by a holder on margin, nevertheless shares of stock so held are capable of identification.

2. In holding that the communication to the stock broker of an intention to hold the first shares purchased on margin was an identification of the

shares sold within the meaning of Article 58, Regulations 74.

3. In holding that Article 58, Regulations 74, had no application to this case.

4. In reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The decision below conflicts in principle with the decision of the Circuit Court of Appeals for the Second Circuit in *Skinner* v. *Eaton*, 45 F. (2d) 568, certiorari denied, 283 U. S. 837. The distinction attempted by the court below is unsound.

In this case the decedent held shares of stock on margin, acquired at different times and at various prices. During the taxable year he sold part of the shares, and the question is what cost basis is to be used.

Article 58 of Regulations 74, *supra*, provides that when shares of stock are sold from lots purchased at different times and at different prices and the identity of the lots cannot be determined, the stock shall be matched against the earliest purchases. This regulation, commonly known as the "first in, first out" rule, has been in effect under all the Revenue Acts [1] and has received legislative and

[1] Article 4, Paragraph 60, Regulations 33 (Revised), promulgated under the 1916 Act; Article 39, Regulations 45, 62, 65, and 69, promulgated under the Revenue Acts of 1918, 1921, 1924, and 1926, respectively; and Article 58 of Regulations 74 and 77, promulgated under the Revenue Acts of 1928 and 1932, respectively.

judicial approval. *Skinner* v. *Eaton, supra; Howbert* v. *Penrose,* 38 F. (2d) 577 (C. C. A. 10th). The court below has sustained and applied the rule in similar cases. *Snyder* v. *Commissioner,* 54 F. (2d) 57; *Snyder* v. *Commissioner,* decided September 18, 1934, 73 F. (2d) 5; *Horner* v. *Commissioner,* 72 F. (2d) 407; *Commissioner* v. *Merchants' & Mfrs'. F. Ins. Co.,* 72 F. (2d) 408. As pointed out by the court below in the first *Snyder* case, *supra,* the rule was apparently adopted with particular reference to marginal transactions where identification is impossible.

The mechanics of a marginal transaction is a matter of common knowledge. Each customer is merely charged on the broker's books with the number of shares ordered. No entry is made on the books of the serial numbers of the certificates. The certificates are not issued in the name of the customer, but in the name of the broker or street names. The broker makes no allocation of the particular certificates to any particular client, nor are the certificates earmarked in any way. All stock of the same kind is commingled and held by the broker for the common benefit of all dealing in that particular stock. Marginal stock held by the broker is, therefore, a "fungible mass." See *Sexton* v. *Kessler,* 225 U. S. 90, 98. Particular shares are not identifiable, because the common fund is the common property of all dealing in that stock and this common fund is in a constant state of flux.

The regulation was designed to meet just such a situation and provides for a cost basis in these transactions where identification is impossible.

Although approving of the regulation, the court below held that it has no application here because the decedent identified the shares sold as the latest shares purchased. The decedent's first purchase of stock was made with funds derived from his father's estate, and he intended to keep that stock intact as an investment. He so notified his broker. The court below held that decedent's communication to his broker of his intention to retain the first purchases was identification sufficient to take the case out of the rule, despite the fact that the broker could not say what shares had been sold (R. 34). Thus, the court allows a mere declaration of intention to take the place of the factual identification required by the regulation. In so holding the decision below conflicts in principle with *Skinner* v. *Eaton, supra,* where the Circuit Court of Appeals for the Second Circuit said (p. 570):

> In support of their claim, the appellants * * * rely upon the testimony of the associates of the taxpayer, who said that the decedent told them he intended to retain his original holdings in the corporation, and that he intended to sell certain stock purchased for return. These statements are alleged to have been made in 1914 and 1915. The declarations of a taxpayer as to his intention to sell the more recently purchased

> stock and to retain his original holdings, made orally, are insufficient to change the result. They indicate merely a purpose which he may not have adhered to. They in no way marked the particular shares of stock here under consideration, the identity of which the trial judge has found to have been lost.

The decision is also inconsistent with the court's earlier decisions referred to above, where it had held that an intent or purely mental condition falls short of evidential identification.[2] See also *Howbert* v. *Penrose, supra,* where it was held (p. 578) that intent of the seller "is some evidence as to what was done, but not conclusive."

The decision below is also opposed to the decisions of the District Courts in *Towne* v. *M'Elligott,* 274 Fed. 960 (S. D. N. Y.), and *Cole* v. *Helburn,* 4 F. Supp. 230 (W. D. Ky.), and to a long line of Board of Tax Appeals decisions. *Leng* v. *Commissioner,* 22 B. T. A. 149; *Jenks* v. *Commissioner,* 22 B. T. A. 910; *Hedrick* v. *Commissioner,* 24 B. T. A. 444; *Stryker* v. *Commissioner,* 21 B. T. A. 561;

[2] The court attempted to reconcile its earlier position by stating that mere intent, even though communicated to the taxpayer's associates, is not enough. It held that here there was "something more"; namely, the communication of the intent to the broker, which was sufficient to take the case out of the rule. However, we submit that where it is impossible even for the broker to identify (R. 34) a declaration of intent made to the broker is not different from a similar declaration made to the taxpayer's associates as in the *Skinner* case, *supra.*

Scanlon v. *Commissioner*, 21 B. T. A. 1120; *Cleveland Trust Co.* v. *Commissioner*, 24 B. T. A. 132; *Finlay* v. *Commissioner*, 17 B. T. A. 828; *Champion* v. *Commissioner*, 27 B. T. A. 1312; *Mickler Holding Co.* v. *Commissioner*, 29 B. T. A. 300; *Kelchner* v. *Commissioner*, 31 B. T. A. 262; *Seelye* v. *Commissioner*, 29 B. T. A. 695.

The court below sought to make a distinction between a sale of certificates and a sale of shares. See also the second *Snyder case, supra.* It recognizes that in marginal transactions certificates cannot be identified, but holds that shares, as distinguished from certificates, are capable of identification. This so-called distinction does not exist. If the shares are capable of identification, it is only by means of certificates or some other evidence of ownership. Shares of stock as such have "no earmark which distinguishes one share from another." *Richardson* v. *Shaw*, 209 U. S. 365, 379; *Duncan* v. *Johnston & Co.*, 3 F. (2d) 422 (C. C. A. 6th). Where, as here, shares bought on margin are not represented by identifiable certificates, it is utterly impossible to identify them, and the need for a rule such as is contained in the regulation is apparent. Since the broker cannot identify the certificates, it is not apparent how the communication of the taxpayer's intention to the broker can add anything to the intention itself. The court below concedes that the latter is insufficient.

2. The decision below deals with a class of transactions in which a large number of taxpayers

engage, and it injects an element of uncertainty in the administration of the law. Marginal transactions are of common and frequent occurrence. A number of cases involving the application of the regulation to these transactions have already arisen, as is evidenced by the decisions referred to above. The Treasury Department advises that a large number of cases of this character are now pending in the Bureau. Undoubtedly similar cases will continue to arise in the future. It is important in the administration of the revenue that the proper method of computing gains and losses on this type of transaction be settled. In holding that shares of stock may be identified, even though the certificates are admittedly unidentifiable, and in holding that a mere declaration of intent made under the circumstances here present is sufficient identification, the decision below deprives the regulation of its effectiveness in the field of its most common application—that is, to marginal transactions. If permitted to stand, the decision below will create considerable confusion and doubt as to the proper rules to be applied in these cases. It is important, therefore, that this Court pass upon this case and establish rules to guide the Government and taxpayers in future cases of this character.

Wherefore, it is respectfully prayed that this petition be granted.

J. CRAWFORD BIGGS,
Solicitor General.

DECEMBER 1934.

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